

ORIGINAL

DIVISION OF CONSUMER ADVOCACY
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Consumer Affairs
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PUBLIC UTILITIES
COMMISSION

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
MOLOKAI PUBLIC UTILITIES, INC.)
For Review and Approval of Rate Increases;)
Revised Rate Schedules; and Revised)
Rules.)

DOCKET NO. 2009-0048

DIVISION OF CONSUMER ADVOCACY'S
STATEMENT OF PROBABLE ENTITLEMENT

Pursuant to the Commission's Order Approving Proposed Procedural Order, issued on November 6, 2009, the Division of Consumer Advocacy ("Consumer Advocate") respectfully submits its Statement of Probable Entitlement in the above docketed matter.

I. INTRODUCTION.

HRS 269-16(d) states that an interim decision allows the Hawaii Public Utilities Commission ("Commission") to grant an increase in rates, fares and charges, if any, to which the Commission believes the public utility is probably entitled based on the evidentiary record in a ratemaking proceeding. It is the Consumer Advocate's

understanding that this statutory provision was enacted to be fair to both the utility and the ratepayer. There is mitigated adverse impact, if any, to the utility from any delays in implementing the rate relief that is deemed just and reasonable by granting the utility interim rate relief, based upon the revenue requirement to which the Commission will likely find reasonable in its final decision and order (i.e., the increase in revenue requirement to which the utility is probably entitled). Should the interim rate relief be higher than the relief found to be just and reasonable in the final Decision and Order, the ratepayer is protected since the public utility must return, in the form of an adjustment to rates, any amounts received under the interim rates that are in excess of the rates, fares, or charges finally determined to be just and reasonable by the Commission. Interest that is computed at a rate equal to the rate of return on the public utility's rate base found to be reasonable by the commission must also be imputed on the amount to be returned.

Given the above, the determination of probable entitlement should be based on that level of revenue requirement and resulting rates which the Commission is likely to determine in the final decision and order to be just and reasonable based on the evidence in the record.

II. PROCEDURAL HISTORY.

On March 2, 2009, Molokai Public Utilities, Inc. ("MPUI") filed its Application for Approval to Increase Rates ("Application"). MPUI's Application included the direct testimonies, exhibits and workpapers in support of its Application. The Commission

ordered MPUI to re-file its Application to include the filing of audited financial statements by MPUI.

On June 29, 2009, MPUI re-filed its Application and the Commission confirmed completion upon issuance of its Order Regarding Completed Application and Other Matters, issued on July 29, 2009.

On September 3, 2009, an advertised public hearing was held at the Mitchell Pauole Center Conference Room in Kaunakakai, Molokai, as required by HRS § 269-16, with notice pursuant to HRS § 269-12.

On September 11, 2009, the County of Maui ("County") and West Molokai Association ("WMA") filed their respective motions for intervention or to participate in the proceeding with the Commission.

On September 14, 2009, Stand for Water filed its respective motion for intervention or to participate in the proceeding with the Commission.

On October 16, 2009, the Commission granted intervention to the County and WMA and unilaterally named Molokai Properties, Limited ("MPL") as a party.

On January 19, 2010, the Commission, on its own motion, dismissed Stand for Water as an intervenor based upon the Commission's determination that Stand for Water failed to assist in developing a sound record and participate meaningfully in the docket.

As a result, the parties to the proceeding are MPUI, the Consumer Advocate, the County, and WMA.

Pursuant to the Commission's Order Approving Proposed Procedural Order, filed on November 6, 2009, the Consumer Advocate submitted several rounds of information requests to MPUI and in turn, MPUI submitted its relevant responses.

The Consumer Advocate filed its Direct Testimonies, Exhibits, and Workpapers on January 13, 2010.

Settlement discussions are ongoing, however, pursuant to the Procedural Order, the parties are to file their respective Statement of Probable Entitlement on March 10, 2010, and the Consumer Advocate is to file its Response to MPUI's Statement of Probable Entitlement on March 17, 2010.

III. DISCUSSION.

A. BACKGROUND REGARDING THE PRESENT RATES.

The currently effective rates were approved by the Commission in its Order Approving Temporary Rate Relief for MPUI and Wai'ola O Moloka'i, Inc. ("Temporary Rate Relief Order") filed in Docket No. 2008-0115 on August 14, 2008. The current effective rates were implemented to address the apparent, urgent need for rate relief for MPUI and Wai'ola O Moloka'i ("WOM"), who, if their asserted needs were not addressed, contended that they would be terminating utility service to all of its service customers. Otherwise, the last Commission approved rates which were the result of a complete investigation were derived in Docket No. 02-0371 and approved by the Commission in Decision and Order No. 20342, filed on July 18, 2003.

For purposes of the Consumer Advocate's analysis, the Consumer Advocate used the rates approved in Decision and Order No. 20342 since temporary rates are

generally not taken to be “permanent” rates as they are not the result of a complete and full record as is developed in a standard rate proceeding. The Consumer Advocate’s position appears to be supported by the Commission’s Order Denying Molokai Public Utilities, Inc.’s Request To Submit Its Unaudited Financial Statements In Lieu Of Audited Financial Statements filed on April 2, 2009 in the instant proceeding. As set forth in its discussion on page 9 and in ordering paragraph four, the Commission instructed the utility company to calculate any increase using the rates approved in Docket No. 02-0371 as the base since calculating any increase using the temporary rates approved in Docket No. 2008-0115 would be “misleading and improper.”¹

B. THE CONSUMER ADVOCATE’S REVENUE REQUIREMENT IS REASONABLE.

First, the Consumer Advocate would like to make clear that it takes seriously the possible risk that, if not properly compensated, a utility company might not be able to provide quality and reliable service to utility customers. Usually, this risk is possible or remote, but not probable. In MPUI’s instance, given its public statements in 2008, the Consumer Advocate seriously considered the risk associated with MPUI again asserting that it would terminate services if the revenue requirements authorized by the Commission would not allow sufficient coverage of MPUI’s fixed and variable costs. This consideration when combined with the Consumer Advocate’s extremely heavy workload and limited resources resulted in a review that, while complete, did not attempt

¹ The Consumer Advocate notes that MPUI’s position appears to be that the Consumer Advocate’s position is incorrect. See, for example, page 2 of MPU-RT-100.

to recommend every possible adjustment that could have been raised.² Still, the Consumer Advocate contends that its recommended revenue requirements reflect a reasonable level that would allow MPUI to recover sufficient revenues to cover costs and not unduly burden MPUI's customers for events that appear to have affected MPUI's operations (e.g., the loss of sales associated with certain customers that no longer exist).

As identified on MPU-R-1, page 1, the major differences in the test year expenses are as follows:

- Depreciation (\$78,891);
- Materials & Supplies (\$71,573);
- Regulatory Expense (\$70,794);
- Fuel Expense (\$29,646);
- Labor and Benefits Expense (\$28,577); and
- Electricity Expense (\$20,410).

The major differences in rate base are primarily related to the concern that MPUI was not able to adequately address and support the assertion that all plant costs are properly recorded, supported by proper documentation, and not otherwise recovered through other means (difference of about \$1 million).

Rather than recounting each revenue requirement element, the Consumer Advocate will only discuss the outstanding differences. In addition, the Consumer Advocate will not go over each difference in great detail as the Consumer Advocate has

² See pages 8 through 11 of CA-T-1 for a greater discussion of the Consumer Advocate's general analytical approach.

already discussed these issues and has offered the reasons why its recommendations are reasonable as set forth in the Consumer Advocate's direct testimony. Furthermore, the Consumer Advocate contends that MPUI has not adequately addressed these concerns in its rebuttal testimony and, thus, the Consumer Advocate contends that its recommendations in its direct testimony remain reasonable.

1. Plant and Associated Depreciation.

The Consumer Advocate has recommended disallowance of certain plant items because the Company has reflected book depreciation for certain items, but has not reflected any tax depreciation for these items. As a result of its inability to find records on why this discrepancy occurs, MPUI has recommended that all income taxes expenses and associated items should be excluded from the instant proceeding. The associated items would essentially consist of accumulated deferred income taxes with the accumulated Hawaii State Capital Goods Excise Tax Credit also being excluded. The Consumer Advocate is concerned that if MPUI's recommendation were adopted, this would not be sound policy as the Commission should make clear that it is any utility company's responsibility to meet its burden of proof by providing a complete case with ample supporting evidence and that, if an integral item such as income taxes, which affects multiple revenue requirement elements, cannot be supported, a utility company should not be allowed to simply recommend excluding all such items.

The Consumer Advocate's recommendation was that the Commission should consider either suspending the docket or dismissing the application to allow this matter to be resolved. If either one of these is adopted, the currently effective temporary rates

should continue until the Commission approves some other set of rates. In the alternative, if the Commission decides that it is appropriate to continue moving forward in this proceeding, MPUI should be required to provide reasonable estimates for income taxes, accumulated deferred income taxes, and capital goods excise tax credit balances. Further, if no support can be provided to justify why it is appropriate to reflect book depreciation without corresponding tax depreciation, the appropriate amounts should be excluded from the plant in service balance and the estimated depreciation expense.³

2. Materials & Supplies.

The Consumer Advocate's concerns with MPUI's estimates were primarily based upon the observed differences resulting from changes in accounting procedures without adequate support to justify the reasonableness of those changes and observed differences between the Company's test year estimates and the available support. Thus, the Consumer Advocate recommended an adjustment to the test year estimate as well as suggesting that the Commission might require a management audit and/or a time and motion study to evaluate the efficiency of the time allocated to MPUI as well as the appropriateness of allocating the time to MPUI.⁴

³ See, the discussion in CA-T-1, pages 38 through 48.

⁴ See discussion offered on pages 32 through 35 in CA-T-1.

3. Regulatory Expense.

The Company originally estimated \$55,000 in its original application and did not modify this estimate in its amended application. However, as outlined in its rebuttal testimony, MPUI is now estimating that its regulatory expense should be \$125,794. The reasons for this significant increase are discussed on pages 27 through 33 of MPU-RT-100. While the Consumer Advocate is not able to appropriately challenge the reasonableness of contractually specific related expenses, the Consumer Advocate is concerned that such significant costs are being incurred on this rate proceeding and with the possible impact on ratepayers if the Company's revised estimate is adopted for ratemaking purposes.

4. Fuel and Electricity Expense.

The Company's original fuel and electricity expense estimates appeared to have been subjectively determined since MPUI did not seem to offer any type of developing the unit of energy associated with recorded sales to apply any such analysis to the forecasted test year sales to ensure that there would be some sort of consistency between these test year revenue requirement elements. As a result, I recommended a methodology that would clearly establish that relationship.

MPUI appears to generally accept the concept of determining the test year fuel and electricity expense using formulae that reflects the relationship between the fuel and electricity expenses and test year sales. Their main issue now appears to be the appropriate cost per unit to use for electricity and fuel. I acknowledge that some further consideration might be appropriate, but am concerned with MPUI's proposal. Hawaii

and the rest of the world experienced an extremely significant increase in energy prices in 2008 that have not yet been duplicated. Yet, MPUI's proposal to use a three-year average does not seem to reflect any type of adjustment to accommodate this aberration. In fact, even though MPUI's rebuttal testimony was filed in February 2010, its proposed three-year average ends with the recorded values from June 2009.

Thus, while further consideration may be appropriate, the Consumer Advocate contends that until additional evidence is provided, it is appropriate to use the values set forth in the Consumer Advocate's estimates and discussed on pages 29 through 30 of CA-T-1 for fuel and power expense.

5. Labor and Benefits Expense.

MPUI's labor and benefits expense test year estimate was \$209,865 and the Consumer Advocate recommended that certain adjustments be made, primarily to reflect the removal of one position that was not going to be filled, the removal of any salary increase, and to reflect the reduction of benefits to reflect a greater level of contributions from employees for those benefits.⁵

MPUI's rebuttal testimony acknowledges the fact that the position in question will not be filled and should be removed from the test year estimates.⁶ However, MPUI contends that it should be allowed to reflect an increase in its pay rates, reflect the Company's almost 100% coverage of all employee benefits and any resolution to the benefits issue should be allowed to be reflected in the next rate proceeding.

⁵ See pages 25 through 28 for CA-T-1.

⁶ See page 6 of MPU-RT-100.

Given the current economy, where people are still being asked to endure pay cuts, furlough days, etc., MPUI's recommendation in its rebuttal testimony does not appear to adequately justify its original recommendation. It is the utility company's burden to justify the amounts included in its request. Thus, if the Company contends that the wages and salaries increases should be allowed, the Consumer Advocate contends that MPUI must demonstrate that its compensation package is inadequate and that, without such increases, MPUI will not be able to attract and/or retain qualified employees, it should provide that information.

6. Other Matters.

As discussed earlier, the Consumer Advocate's discussion in this statement of probable entitlement focused on the major differences between MPUI and the Consumer Advocate. There are other areas which reflect differences between the parties. Some of these differences relate to calculated numbers, such as working cash and taxes other than income taxes. Other items are relatively nominal as compared to the items discussed earlier in this document. Notwithstanding these other items of differences not discussed, there are additional matters which should be discussed.

a. Rate design.

As discussed on pages 50 through 53, additional analysis of the appropriate rate design is necessary, but it does not appear reasonable to conduct that analysis in the instant rate proceeding. Given the recent changes in the service territory regarding the loss of key customers and continued results of the current economic conditions in

Hawaii and on Molokai, conducting any such analysis would have extremely limited value as those conditions will (hopefully) change and any such analysis would likely yield skewed results. For this reason, the Consumer Advocate agrees that an "across-the-board" increase of the results of the Commission's decision in its final decision and order as well as any interim decision and order would be appropriate.

b. Strongly recommend avoiding the need for a refund.

The Consumer Advocate contends that its recommended revenue requirement is reasonable. However, as acknowledged in direct testimony, it may be possible that MPUI will be able to provide additional information that might support changing some of the Consumer Advocate's estimates. However, as that information has not yet been submitted, the Consumer Advocate would like to emphasize that if MPUI's rebuttal position is adopted as the appropriate level of revenue requirements for probable entitlement and the Commission later decides that MPUI has not adequately supported its revised request, a refund to customers of the difference between the interim and final rates would be required. As recommended by the Consumer Advocate, there should be no rate of return even though MPUI continues to assert that some level of return, two percent, is appropriate. If a refund is necessary, the appropriate interest will also need to be calculated and MPUI will need to develop a refund plan for Commission approval.

The Consumer Advocate contends that it is more appropriate, especially in these current economic conditions, that the Commission adopts the lowest possible revenue

requirement estimate⁷ in order to avoid: 1) unnecessarily taking money out of the utility customers' pockets even if it will be returned in the future in the event of a refund; and 2) the regulatory work that would be required to develop and calculate a refund plan.

IV. RECOMMENDATION.

In conclusion, MPUI is probably entitled to a rate increase of 109.4% (i.e., $(\$858,737 - \$410,153) \div \$410,153$). The calculation of this amount is illustrated on Attachment 1 to this statement of probable entitlement and greater details on the basis for each revenue requirement element and the calculations can be found in CA-T-1 and the supporting exhibits and workpapers. For the reasons discussed in the Consumer Advocate's Direct Testimony, the entire increase should be applied on an across-the-board basis.

DATED: Honolulu, Hawaii, March 10, 2010.

Respectfully submitted,

By 
DEAN NISHINA
Executive Director

DIVISION OF CONSUMER ADVOCACY

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The Consumer Advocate notes that MPUI has not offered a similar comparison of its position with the other party in this proceeding who provided pre-filed direct testimony, the West Maui Association ("WMA"). However, based on exhibit WMA 101, it appears that WMA has recommended a total revenue requirement of \$878,018, which is greater than the Consumer Advocate's recommended level of \$858,737. Thus, the lowest recommended level of revenue requirements in the instant proceeding appears to the Consumer Advocate's \$858,737.

Molokai Public Utilities, Inc.
Revenue Requirements & Rate of Return Summary
Test Year Ending June 30, 2010

Line #		(1) Present Rates	(2) Additional Amount	(3) Proposed Rates at 0.00%
1	Monthly Customer Charge	\$52,688	\$58,674	\$111,362
2	Water Usage Charge	356,165	389,910	746,075
3	Other	0		0
4	Connection Fees	0		0
5	Late Fees	1,300		1,300
6				
7	Total Operating Revenues	410,153	448,584	858,737
8	Labor, Payroll Taxes & Employee Benefits	165,308		165,308
9	Fuel & Power Expense	303,680		303,680
10	Department of Agri - Rental/Service	144,458		144,458
11	Cost of Sales	0		0
12	Materials & Supplies	14,010		14,010
13	NOT USED	0		0
14	Affiliated Charges	9,800		9,800
15	Professional & Outside Services	14,137		14,137
16	Repairs & Maintenance	65,812		65,812
17	NOT USED	0		0
18	Insurance	13,000		13,000
19	Regulatory Expense	55,000		55,000
20	General & Administrative	13,318		13,318
21	Other	0		0
22	Other	0		0
23	Total O&M Expenses	798,321	0	798,321
24	Taxes, Other Than Income	26,168	28,642	54,830
25	Depreciation	5,587		5,587
26	Amortization	0		0
27	Income Taxes	0	(0)	(0)
28	Diff. due to changing factors			0
29	Total Operating Expenses	830,098	28,642	858,738
30	Operating Income	<u>(\$419,943)</u>	<u>\$419,942</u>	<u>(\$1)</u>
31	Average Rate Base	<u>\$0</u>		<u>\$0</u>
32	Return on Rate Base	0.00%		<u>0.00%</u>
33	Target ROR	<u>0.00%</u>		
34	Increase in ROR	<u>0.00%</u>		
35	Increase in NOI	803,908		
36	Gross Revenue Conversion Factor	<u>1.06820</u>		
37	Increase in Revenues	<u>\$448,581</u>	<u>(\$3)</u>	
38	Percent Increase in Revenue		<u>109.37%</u>	

Molokai Public Utilities, Inc.
Income Tax Expense
Test Year Ending June 30, 2010

		[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Line #	Description	Taxable Amounts				Income Taxes		Difference in Income Tax Calculations [4] + [5] - [6]	
		Tax Rates	Present Rates	Revenue Increase	Proposed Rates	Present Rates	Revenue Increase		Proposed Rates
1	Total Revenues					410,153	448,584	858,737	
2	Total Operations & Maintenance Expenses					798,321	0	798,321	
3	Depreciation					5,587	0	5,587	
4	Amortization					0	0	0	
5	Taxes Other than Income Taxes					26,188	28,642	54,830	
6	Total Operating Expenses					830,096	28,642	858,738	
7	Operating Income before Income Taxes					(419,943)	419,942	(1)	
8	Interest Expenses					-	-	-	
9	State taxable income					(419,943)	419,942	(1)	
	Less:								
10	State income Tax								
11	less than \$25K	4.4%	(25,000)	25,000	(1)	0	1,100	(0)	
12	Over \$25K, but less than \$100K	5.4%	(75,000)	75,000		0	4,050	0	
13	Over \$100K	6.4%	(319,943)	319,942		0	20,476	0	
14	State Income Tax					0	25,626	(0)	25,626
15	Federal taxable income					(419,943)	394,316	(1)	
16	Federal income tax								
17	less than \$50K	15.0%	(50,000)	50,000	(1)	0	7,500	(0)	
18	Over \$50K, but less than \$75K	25.0%	(25,000)	25,000		0	6,250	0	
19	Over \$75K, but less than \$100K	34.0%	(25,000)	25,000		0	8,500	0	
20	Over \$100K, but less than \$335K	39.0%	(235,000)	235,000		0	91,650	0	
21	Over \$335K	34.0%	(84,943)	59,316		0	20,167	0	
22	Federal Income Tax					0	134,067	(0)	134,067
23	Total Federal and State income taxes					\$0	\$159,694	(\$0)	\$159,694
24									
25	Effective Tax Rate					0.0000%	38.0275%	18.7400%	
26	State					0.000%	6.102%	4.4000%	
27	Federal					0.000%	31.925%	14.3400%	

CA-101
Docket No. 2009-0048
Page 2 of 3

Attachment 1
Docket No. 2009-0048
Page 2 of 4

Molokai Public Utilities, Inc.
Taxes Other Than Income Taxes
Test Year Ending June 30, 2010

Line #	Description	[1] Revenues at Present Rates	[2] Revenues at Proposed Rates	[3] Tax Rates	[4] Taxes at Present Rates	[5] Taxes at Proposed Rates
<u>Revenue Taxes</u>						
1	Public Company Service Tax (Pursuant to HRS § 239)	\$410,153	\$858,737	5.885%	\$24,138	\$50,537
2	Public Utility Fee (Pursuant to HRS § 269-30)	410,153	858,737	0.500%	2,051	4,294
3	Franchise Tax (applicable to electric companies only) (Pursuant to HRS § 240)			2.500%		
4	Total Revenue Taxes				<u>26,188</u>	<u>54,830</u>
<u>Other Taxes</u>						
5	Name					0
6	Total Other Taxes				<u>0</u>	<u>0</u>
7	Total Taxes Other Than Income Taxes				<u>\$26,188</u>	<u>\$54,830</u>

CA-101
Docket No. 2009-0048
Page 3 of 3

Molokai Public Utilities, Inc.
Average Rate Base
Test Year Ending June 30, 2010

		[1]	[2]	[3]
Line #	Description	At June 30, 2009	At June 30, 2010	Average
	<u>Plant In Service</u>	\$6,535,783	\$6,550,283	\$6,543,033
1	Accumulated Depreciation Reserve	6,476,798	6,482,384	6,479,591
2	Net Plant-in-Service	58,985	67,899	63,442
	<u>Deduct:</u>			
3	Net Contributions in Aid of Construction	0	0	0
4	Customer Advances	0	0	0
5	Customer Deposits	(10,691)	(10,691)	(10,691)
6	Accumulated Deferred Taxes: Federal	0	0	0
7	Accumulated Deferred Taxes: State	0	0	0
8	Unamortized Hawaii General Excise Tax Credit	(207,931)	(191,130)	(199,531)
9	subtotal	(218,622)	(201,821)	(210,222)
	<u>Add:</u>			
10	Working Capital	65,417	65,417	65,417
11	Retirements	0	0	0
12	TY Adjustment	94,219	68,506	
13	subtotal	159,636	133,923	65,417
14	Total at End of Year	(\$0)	\$0	
15	Average Rate Base For Test Year			\$0

CA-102
Docket No 2009-0048

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S STATEMENT OF PROBABLE ENTITLEMENT** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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DATED: Honolulu, Hawaii, March 10, 2010.

A handwritten signature in cursive script, reading "Desiree L. Neal", is written over a horizontal line.